Securities Regulation Daily Wrap Up, TOP STORY—DOL fiduciary rule withstands annuity group's challenge, (Nov. 7, 2016)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The D.C. District Court would not enjoin the Department of Labor's fiduciary rule or otherwise sustain a challenge by the National Association for Fixed Annuities. NAFA had argued that the agency exceeded its statutory authority and improperly categorized insurance agents as fiduciaries. But the new fiduciary rule was, if anything, more compliant with the statute than the five-part test under the 1975 fiduciary regulation, and the fact that commission-based compensation is standard practice among sellers of fixed annuities does not impermissibly convert the best interest contract exemption (BICE) into a mandate (*The National Association for Fixed Annuities v. Perez*, November 4, 2016, Moss, R.).

In its complaint, NAFA challenged the DOL's authority to redefine "investment advice" and "fiduciary" under ERISA and the Internal Revenue Code. According to NAFA, the rule creates a private right of action, which only Congress can do. Moreover, Congress determined that fixed annuities should be regulated by the states, not the federal securities laws. NAFA also argued that the DOL's decision to include fixed indexed annuities (FIAs) under the BICE, rather than prohibited transaction exemption 84-24 as originally proposed, without an "opportunity for meaningful comment and without adequate justification was arbitrary and capricious." NAFA sought an injunction that would block the rule from taking effect as scheduled on April 10, 2017.

Removal of "on a regular basis" condition. The court's comprehensive opinion came down entirely on the DOL's site, granting summary judgment for the agency and denying any relief for NAFA. The court repeatedly returns to a particular theme: the agency's 2010 attempt to redo the 1975 fiduciary framework, which it scrapped the following year. In proposing the amendments in 2010, the Department explained that the extant five-part test, among other things, no longer reflected the state of the financial industry. The 1975 framework permitted insurance companies to pay commissions on sales of variable and fixed annuities held in ERISA plans and IRAs where the relevant investment advice was not provided "on a regular basis." But a shift over the decades from defined benefit to defined contribution plans meant more and more investors sought advice on one-off, but significant, transactions such as 401(k) rollovers. The decision on how to invest these rollovers "will be the most important financial decision that many consumers make in their lifetime," the agency noted in the 2015 reproposal.

***Chevron* analysis.** Contrary to NAFA's arguments, the court held that the fiduciary rule passed the first two steps of *Chevron*. First, the DOL did not exceed its statutory authority by abandoning the five-part test for a person who "renders investment advice" in favor of a definition that encompasses a "recommendation as to the advisability of acquiring … investment property" that understands "that the advice is based on the particular investment needs of the advice recipient." The statute does not define the phrase "investment advice," and ERISA authorizes the agency to define "technical and trade terms" used in the statute. There can be no serious dispute that the rule's definition conflicts with ordinary usage of the term "investment advice," the court wrote. If anything, it is the five-part test that is difficult to reconcile with the statutory text, as nothing in the phrase "renders investment advice" suggests that the statute applies only to advice provided "on a regular basis."

At step two of *Chevron*, the court defers to the agency's permissible interpretation of the statute, as long as it is backed up by a reasoned explanation. The DOL's interpretation was reasonable and reasonably explained, the court concluded. The new interpretation hews closer to the rule than the five-part test embraced by NAFA, and it fits comfortably with the purpose of ERISA to protect the interests of retirement plan participants. NAFA's contention that market changes alone are insufficient to justify a change in the definition of "fiduciary" was

unconvincing; the Department's interpretation did not distort statutory meaning simply to achieve a regulatory end and was backed up by a lengthy explanation of how the relationship between advisers and investors has changed. Furthermore, the Supreme Court has rejected the contention that agencies are subject to a heightened standard when departing from long-established interpretations.

Agency is allowed to depart from longstanding interpretation. NAFA also unsuccessfully challenged the rule's requirement that fiduciaries who advise IRAs agree to be bound by the duties of loyalty and prudence as a condition of PTE 84-24 and the BICE. Although it was undisputed that title I of ERISA does not authorize the Labor Department to impose fiduciary duties on those who advise IRAs, that argument has no bearing on the agency's title II authority. The plain language of the statute authorizes the DOL to adopt non-statutory exemptions and condition those exemptions. The exemption authority's result—subjecting IRA advisers to ERISA duties only if they are paid commissions—is not an absurd result but precisely the point of the exemption, as the Department is concerned about conflicted advice resulting from commission arrangements. Although it may be difficult and costly for financial institutions to move away from commission-based compensation, that choice is real.

Fiduciary rule does not create new cause of action. Furthermore, the court rejected NAFA's argument that the BICE impermissibly creates a private cause of action. Rather than doing so, the BICE merely dictates the terms that otherwise conflicted institutions must include in written contracts with non-title I owners in order to qualify for the exemption. Any action to enforce the terms of those contracts would be brought under state law, which ultimately would control the enforceability of the contract terms. Annuities are contracts which were already subject to suit for breach prior to promulgation of the BICE; the exemption only requires financial institutions to include particular terms in those contracts to qualify.

The case is No. 16-1035.

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Companies: National Association for Fixed Annuities

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